The Impact of CEO Narcissism on Corporate Tax Sheltering An Empirical Study

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Abstract

Corporate tax sheltering is a legal action that may be taken by companies to achieve a better financial position. Chief executive officer (CEO) plays a unique role in determining the Company's tax strategies. Meanwhile, CEO personal traits can affect the company strategy and outcomes. Many of CEO personality traits that affecting firm outcomes have been examined in the literature. Particularly, narcissism is considered as a major CEO trait, which is associated with overconfidence, and willingness to take risks. This research focuses on narcissism trait which is seen as one of the most complex and highly researched personality traits in prior studies. Moreover, this study focuses on examining the relationship between CEO narcissism and corporate tax sheltering which is considered as an aggressive form of corporate tax avoidance and has become a general feature of today´s business landscape (Lanis & Richardson, 2011). This study is based on a sample comprises 48 non–financial firms summing up 267 firm-year observations for the period from 2014 to 2019. An Ordinary Least Squared (OLS) regression and Feasible Generalized Least Square (FGLS) regression are conducted to examine the hypothesis. Contrary to expectations, the results show insignificant negative relationship between CEO narcissism and corporate tax sheltering which means that no significant relationship is found between CEO narcissism and corporate tax sheltering.

Keywords: CEO Narcissism, Corporate Tax Sheltering, Firm Value, EGX, Egypt.

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1. Introduction

The literature suggests that chief executive officers (CEOs) have a major role in determining tax strategies, which make them involved in tax avoidance tactics (Ernst & Young, 2004). Therefore, CEOs apply strategies to decrease their corporate taxes. According to Dyreng, Hanlon, and Maydew (2010), CEOs affect the company' tax avoidance activities. This matches the upper echelons (UE) perspective of Hambrick and Mason (1984) which discuss the role of CEOs in sitting the corporate strategies, UE theory suggests that executive characteristics including personality, values, and cognitive base affect the organizational outcomes (Hambrick & Mason, 1984). Based on the UE perspective, this study examines the effect of CEO narcissism, as a CEO characteristic, on corporate tax sheltering.

According to the literature, narcissism is perceived as a threat for companies because narcissists are often prioritize their own interests in order to bolster their own image (Vazire et al., 2008). Narcissistic CEOs have more confidence in their own tasks (Chatterjee & Hambrick, 2007). Therefore, CEO narcissism is associated with self-interest, overconfidence, and willingness to take risks (Ham et 2 al., 2017). Prior studies found that CEOs can influence tax policies by engaging in the determination of corporate tax strategies or by setting the ‘‘tone at the top’’ within their firms (Olsen and Stekelberg, 2016).

A growing stream of research has examined the effect of CEO narcissism on the ability to avoid corporate taxes, yielding mixed results.. Therefore, the researcher examines whether relative to other CEOs, more narcissistic CEOs are likely to engage in corporate tax sheltering despite the potential negative effects that may result from adopting such policies. The current study employs a variety of firm- and CEO-level control variables to examine the effect of CEO narcissism on corporate tax sheltering. This study hypothesizes a positive relationship between CEO narcissism and corporate tax sheltering.

2. The Theoretical Framework

2.1. CEO Narcissism

Literature suggests that narcissism trait is associated to overvaluation of someone who is treated as a special person (Rijsenbilt, 2011). CEOs are treated as special persons due to the power they have and the highest position they hold within the organization. Narcissistic CEOs can be scored higher or lower on the narcissistic dimension. Narcissism is an important personal trait associated with leadership and the capability to exercise power (Lubit, 2002). Kets de Vries (2004) argued that the need to achieve high success, reach the top of an organization, and attain leadership requires a. literature indicates that narcissistic CEOs are more likely to fulfill leadership roles due to their dominance (Brouwer, 2018). Prior research has indicated that narcissistic CEOs, characterized by dominance, self-confidence, a sense of entitlement, grandiosity, and low empathy, can have both positive and negative effects on firms. Furthermore, narcissism is often viewed as a dark side of personality due to its characteristics, which include arrogance, boastfulness, and self-importance (Resick et al., 2009). Despite their dark-side traits, narcissists have positive traits.

2.2 The Positive and the Negative Aspects of CEO Narcissism

The narcissistic CEOs have positive as well as negative aspects. literature documents positive and negative aspects of narcissism. For example, Lubit (2002) indicated that narcissism has negative and positive effects and classified it into two type "healthy and a destructive narcissism". "Healthy narcissism" is based upon a self-esteem and is not obsessed with power, while a destructive narcissist is obsessed with power. Destructive narcissists do not respect others' rights, are arrogant, devaluing (Rijsenbilt, 2011). In addition, Kets de Vries (1994) indicated that narcissism can be categorized into two types "constructive narcissism and reactive narcissism". Constructive narcissists can use their narcissism effectively and are well balanced, while reactive narcissists have negative emotions like jealousy, revenge and have a self importance which can lead to defective leadership. On the positive side, narcissists are seen as inspirational and are succeeful in situations that need to change, and creative (Gupta & Spangler, 2012; Maccoby, 2007). Maccoby (2000) found that many narcissistic CEOs lead highly successful organizations because they can shape the future as they have personal characteristics such as being passionate, lacking fear and being risk taking. Narcissistic CEOs are likely to undertake more risky actions like innovation, launching of new business and taking more risky actions to be the center of the attention (Miller, 1983; Ham et al., 2017).

On the negative side, narcissistic CEO are more likely to violate integrity standards and make destructive workplaces (Blair, Hoffman, & Helland, 2008; 14 Blickle, Schlegel, Fassbender, & Klein, 2006). Literature indicated that narcissistic CEO are concerned with actions that are only beneficial for themselves (Judge, LePine & Rich, 2006). Narcissistic CEOs believe that they can achieve better performance and achieve their goals in business operations (Wallace & Baumeister, 2002 and Maccoby, 2000) despite of their decision which can cause conflicts and penalties for the organization.

2.3 The Costs and Benefits of Corporate Tax Sheltering

Literature indicated that shareholders are not always interested in corporate tax reduction practices (Amiram et al., 2016) instead they may be questionable. There are benefits and costs to firms engaging in corporate tax sheltering. Benefits include increased after-tax profits, and a reduced tax liability (Hanlon and 22 Slemrod, 2009), an increase in cash and liquidity and reduction in a firm's effective tax rate. On the other side, there are potentially costs result from engaging in corporate tax sheltering including increased legal and penalties costs (Rego and Wilson, 2012), damage to the firm's reputation amongst its various stakeholders (Desai and Dharmapala, 2006; Hanlon and Slemrod, 2009), social sanctions such as boycotts (Hoi et al., 2013) and increased risks faced by the firms engaging in corporate tax sheltering. In addition, executives engaging in tax sheltering strategies are also face high risks of personal penalties and fines, which as a result may damage their reputations. Due to the risks relating to the detection of tax sheltering activities that the manager bears instead of his company, substantial compensation costs are required to offset the higher risks (Chen and Chu, 2005). Therefore, the benefits gained from tax sheltering by the managers who engaging in tax sheltering strategies should exceed the potential costs to encourage managers and organizations to engage in tax sheltering. The researcher views that the costs and benefits of corporate tax sheltering differ across organizations due to the organizations and executives' characteristics.

3. Prior Literature and Hypothesis Development

3.1 CEO Narcissism and Corporate Tax sheltering

Prior studies suggests that CEO searching for tax strategies which result in tax avoidance or minimize their corporate taxes (Ernst & Young, 2004; and Chyz, Gaertner, Kausar & Watson, 2019). According to Dyreng, Hanlon, and Maydew (2010), CEO can affect corporate tax sheltering because they play an important role in deciding the strategic issues, and therefore have the power to make strategic decisions that lead the company. The researcher will focus in examining the effect of CEO narcissism on corporate tax sheltering.

Narcissism represents a threat for companies because narcissists often serve their own interests which support their own image (Vazire, Naumann, Rentfrow & 23 Gosling, 2008). Therefore, CEO narcissism is associated with self-interest, overconfidence, and willingness to take risks (Ham et al., 2017). Narcissistic CEOs try to improve their own company's image as they fell that they can make a difference for their companies and actively avoid taxes which will result in a better financial position.

According to prior studies there are several reasons why CEO narcissism can increase the potential firm's engagement in corporate tax sheltering. Raskin and Terry (1988) indicated that narcissists possess strong senses of superiority and are exploitative which increase their ability to engage in corporate tax sheltering as they expect that they have special treatment and are above the law (Exline et al. 2004). Other research indicated that narcissistic CEOs are more likely to pursue rewards than avoiding negative outcomes from corporate tax sheltering (Foster et al. 2009). The researcher also views that narcissistic CEOs are more likely to engage in corporate tax sheltering to achieve personal gains. According to Olsen and Stekelberg (2016), CEOs can affect corporate tax avoidance through two ways. The first is indirectly based on the upper echelons theory, which suggests that the personality characteristics of the company's top management affect the organizational choices (Hambrick 2007). Based on that theory tax policy adapted by a firm with a narcissistic CEO can be considered as a reflection of the behavioral tendencies of that individual.

The second way is via direct participating in setting their firms' tax policies. According to Dyreng et al. (2010), narcissistic CEOs are interested in high-risk areas, so they integrated in tax systems that support corporate tax sheltering.

Many prior studies discussed the effect of personal characteristics of the CEO on the corporate tax avoidance/sheltering. For instance, Dyreng et al. 24 (2010) examined whether there is association between top executives and corporate tax avoidance and find that narcissistic CEOs are more likely to engage in tax avoidance due to their high self-entitlement. In addition, Chyz (2013) examined whether executives who engaged in personal tax evasion through engaging in a questionable transaction for personal tax gain are more likely to engage in corporate tax sheltering and found that firms with CEOs who evidence a propensity to be aggressive on their personal taxes, are more likely to engage in corporate tax sheltering.

Further, Koester et al. (2014) investigated the association between firms with managers who maximize the efficient use of firm resources and corporate tax avoidance, results indicated that firms with managers who maximize the efficient use of firm resources to avoid more taxes. Finally, Swagerman (2018) investigated the association between CEO narcissism and corporate tax avoidance and examined whether CEO duality moderate and strange this association, results indicated that CEO duality is a crucial factor to affect the relationship between CEO narcissism and corporate tax avoidance. Due to the gap in literature, the researcher focuses on examining the effect of CEO narcissism on the corporate tax sheltering.

3.2 Research Hypothesis

As discussed before literature revealed mixed results related to CEO characteristics particularly CEO narcissism and their effect on the corporate tax sheltering. For example, several studies examined whether executives' incentives affect the corporate tax avoidance of the firm and the results are mixed. From one hand, Phillips (2003) empirically investigated the association between compensation and corporate tax avoidance and found that there was no significant relationship between CEO incentive and corporate tax avoidance. Phillips (2003) findings is supported by Armstrong et al. (2012). On the other hand, Rego and Wilson (2012) and Gaertner (2014) both found that CEO compensation has a significant impact on corporate tax strategy. From another point of view, and in contrast to previous studies, Desai and Daharmapala (2006) analyzed how high-powered incentives compensation influence corporate tax sheltering and found that there is a negative relationship between high-powered incentives compensation and corporate tax sheltering.

Other studies focused on investigating the association between CEO narcissism, compensation, and corporate tax sheltering and result in mixed findings. For example, Dyreng et al. (2010) study is consistent with the study of Olsen and Stekelberg (2016) who examined the effect of CEO narcissism on corporate tax sheltering and found that more narcissistic CEOs are more likely to adopt more aggressive tax avoidance despite the potential negative effects. In contrast to results reported by Dyreng et al. (2010) and Olsen and Stekelberg (2016), Swagerman (2018) examined the relationship between CEO narcissism and corporate tax avoidance and examined whether CEO duality moderate this relationship. Results indicated that no significant relationship is 38 found between CEO narcissism and corporate tax avoidance in general, but they found that when CEO duality moderates this relationship, the effect becomes significant and positive.

Other studies investigated the effect of CEO overconfidence on the corporate tax sheltering as overconfidence is an important executive characteristic. For example, Chyz et al, (2019) is consistent with Kubick and Lockhart (2017) focusing in investigating whether firms with overconfident CEOs engaging in corporate tax sheltering and found evidence that firms with overconfident CEOs are more likely to engage in tax shelters. These results are consistent also with Hsieh et al. (2018) study as discussed before. These mixed results of prior studies motivate the researcher to investigate this relationship between CEO narcissism and corporate tax sheltering. Upon literature, the researcher view that narcissistic CEOs are more likely to engage into aggressive tax strategies to lower the firm's tax burden despite the potential costs related to corporate tax sheltering such as tax authority's penalties and reputational effects which may cause damaging of firm value.

Based on the gap which has been found in the literature, the researcher hypothesizes that CEO narcissism is positively associated to the corporate tax sheltering. The hypothesis is as follows:

H1: There is a positive relationship between CEO narcissism and the corporate tax sheltering.

4. Research Design

4.1 Sample Selection and Data Collection

An empirical study is used to employ the ordinary least squares regression (OLS) model and Feasible Generalized Least Square (FGLS) based on a sample of companies listed in the Egyptian Stock Exchange Market (EGX 100) to test the research hypothesis. The final research sample consists of 48 non-financial firms. The researcher will focus on secondary data due to its availability to the public. The data collected from the annual reports and the published financial statements for the period from 2014 to 2019 from the EGX, the EGX

Electronic Information Services, Mubasher Information Website (www.mubasher.info), and from Argaam Website (www.argaam.com).

4.2 Variable Measurement

CEO narcissism is the independent variable of this study and is measured using CEO signature size due to the availability of data related to the signature size and as this measure is used before in prior studies like, Ham et al. (2018). The corporate tax sheltering is the dependent variable. Many measures have been used to measure corporate tax sheltering in the literature. In line with prior literature, the researcher will use current effective tax rate (CETR) and GAAP effective tax rate (GETR) as a measures of corporate tax sheltering, where a lower ETR indicates that a firm engages in a relatively higher level of tax sheltering.

In addition, the researcher uses some firm and CEO control variables that might affect the relationship between CEO narcissism, corporate tax sheltering and firm value. Those control variables are employed according to the literature (Olsen & Stekelberg, 2016; Ham et al. 2018; Swagerman, 2018). The control variables of this study are; leverage (LEV), return on assets (ROA), firm size, CEO duality, CEO overconfidence (OC), the percentage of female.

4.3 Research Model

To examine the effect of CEO narcissism on corporate tax sheltering, multiple regression model is established to test the research hypothesis. the regression model is established as follows:

$$CETRit = \beta0 + \beta1LNSIGNit + \beta2LEVit + \beta3ROAit + \beta4SIZEit + \beta5DUALITYit + \beta6OCit + \beta7\ \%WOMENit + \varepsilon\ it$$

$$GETRit = \beta0 + \beta1LNSIGNit + \beta2LEVit + \beta3ROAit + \beta4SIZEit + \beta5DUALITYit + \beta6OCit + \beta7\ \%WOMENit + \varepsilon it$$

Where:

CETRit is the corporate tax sheltering measured by Current Effective Tax Rate for firm i at year t

GETRit is the corporate tax sheltering measured by GAAP Effective Tax Rate for firm i at year t

LNSIGNit is the CEO narcissism measured by signature size for firm i at year t

LEVit is the leverage for firm i at year t

ROAit is the return on assets for firm i at year t

SIZEit is the size for firm i at year t

DUALITYit is the CEO duality for firm i at year t

OCit is the overconfidence for firm i at year t

%WOMENit is the percentage of female for firm i at year t

5.Data Analysis and Discussion of Results

5.1 Descriptive Statistics

The descriptive statistics of each variable included in the study model describe the characteristics of the data. This study comprises 48 firms listed on the EGX (100) covering a period from 2014 to 2019; with a total 267 of observations. Table (1) presents the descriptive statistics of mean, standard deviation, minimum and maximum for the dependent, independent, and control variables used in regression models. The sample (N) is 267 for each variable.

Table (1). Descriptive Statistic

Variables	Obs.	Mean	Std. Dev.	Min	Max
CURRENT ETR	267	.157	.108	0	.314
GETR	267	.202	.107	0	.361
LNSIGN	267	1.319	.326	.833	1.825
SIZE	267	14.898	1.239	13.016	17.021
LEV	267	.489	.215	.06	.933
ROA	267	.1	.076	.018	.245
OC	267	-.004	.23	-.338	.418
%WOMEN	267	.091	.117	0	.357

5.2. Correlation Analysis

The Pearson’s correlation is used to investigate whether there are relationships between the dependent, independent, and control variables. Furthermore, it is used to test the collinearity among independent variables. Table (2) summarizes Pearson’s correlation coefficients between the study variables.

Table (2). Pearson's Correlation Matrix

Variables	CETR	GETR	LNSIGN	SIZE	LEV	ROA	OC	DUAILTY	%WOMEN
1. CETR	1.000								
2. GETR	0.660	1.000							
	(0.000)								
3. LNSIGN	-0.002	0.007	1.000						
	(0.978)	(0.907)							
4. SIZE	0.244	0.101	-0.066	1.000					
	(0.000)	(0.099)	(0.282)						
5. LEV	-0.379	-0.325	-0.005	-0.394	1.000				
	(0.000)	(0.000)	(0.939)	(0.000)					
6. ROA	-0.122	-0.138	0.028	-0.247	0.376	1.000			
	(0.046)	(0.024)	(0.649)	(0.000)	(0.000)				
7. OC	-0.063	-0.027	0.015	0.027	-0.016	0.110	1.000		
	(0.302)	(0.665)	(0.810)	(0.662)	(0.788)	(0.074)			
8. DUAILTY	-0.142	-0.117	-0.088	-0.073	0.146	0.189	-0.038	1.000	
	(0.020)	(0.056)	(0.153)	(0.237)	(0.017)	(0.002)	(0.539)		
9. %WOMEN	0.004	0.002	-0.057	-0.136	0.068	0.073	-0.018	0.153	1.000
	(0.954)	(0.975)	(0.356)	(0.026)	(0.267)	(0.232)	(0.768)	(0.012)	

5.3 Regression Analysis

Multiple regression analysis is employed to test the research hypothesis based on OLS and FGLS approaches. The research model is used to test the research hypothesis stated that "*There is a positive relationship between CEO narcissism and corporate tax sheltering*". The research model includes LNSIGN as an independent variable and CURRENT ETR and GETR as dependent variables in addition to using LEV, ROA, SIZE, DUALITY, OC, and %WOMEN as control variables. Table (3) presents OLS and FGLS regression analysis to test the empirical model.

Table (3). OLS and FGLS regression results of the first model.

Variables	**CURRENT ETR**		**GETR**	
	OLS	**FGLS**	**OLS**	**FGLS**
LNSIGN	-0.000589	-0.000589	-0.000146	-0.000146
	(-0.03)	(-0.03)	(-0.01)	(-0.01)
SIZE	0.0110^{*}	0.0110^{*}	-0.00253	-0.00253
	(2.02)	(2.05)	(-0.45)	(-0.46)
LEV	-0.172^{***}	-0.172^{***}	-0.162^{***}	-0.162^{***}
	(-5.26)	(-5.34)	(-4.83)	(-4.91)
ROA	0.0897	0.0897	-0.0111	-0.0111
	(1.00)	(1.02)	(-0.12)	(-0.12)
OC	-0.0387	-0.0387	-0.0152	-0.0152
	(-1.44)	(-1.46)	(-0.55)	(-0.56)
DUAILTY	-0.0254	-0.0254	-0.0180	-0.0180
	(-1.82)	(-1.85)	(-1.26)	(-1.28)
%WOMEN	0.0502	0.0502	0.0291	0.0291
	(0.94)	(0.95)	(0.53)	(0.54)
_cons	0.0823	0.0823	0.331^{***}	0.331^{***}
	(0.87)	(0.88)	(3.39)	(3.44)
N	267	267	267	267
R^2	0.173	-	0.114	-
Probability F test	0.000	-	0.000	-
Probability Wald Ch^2	-	0.000	-	0.000

t statistics in parentheses. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

6. Results and Conclusions

This research examines the impact of CEO narcissism on corporate tax sheltering, which is classified in the literature as an aggressive form of corporate tax avoidance. Narcissistic CEOs are characterized by senses of superiority, feelings of entitlement and self-love. Narcissistic individuals feel that they are above the law, and they can take more risks to achieve the rewards. Prior studies reported mixed results of the effect of CEO narcissism on corporate tax sheltering. Consistent with Swagerman (2018), the researcher found that CEO narcissism has no impact on corporate tax sheltering in Egyptian firms as the results in Table (3) show that the FGLS coefficient of the main independent variable CEO narcissism (LN SIGN) is negatively associated with CURRENT ETR (-0.000589) and GETR (-0.000146) and is statistically insignificant. This implies that there is no impact of CEO narcissism on corporate tax sheltering (CURRENT ETR and GETR). The researcher concludes that these results might be due to the nature of the Egyptian capital market, which is believed to be underdeveloped, and the nature of the Egyptian tax systems which could be different from other countries. In addition, another possible reason could be that CEO narcissism does not only predict corporate tax sheltering directly, but also indirectly through various relationships.

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